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No. 16-529

In the Supreme Court of the United States

CHARLES R. KOKESH, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT

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QUESTION PRESENTED

Whether the Securities and Exchange Commission's equitable claims for disgorgement are subject to the five-year statute of limitations in 28 U.S.C. 2462, which applies to claims for "any civil fine, penalty, or forfeiture."

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BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-19a) is reported at 834 F.3d 1158. The opinion of the district court (Pet. App. 20a-47a) is not published in the *Federal Supplement* but is available at 2015 WL 11142470.

JURISDICTION

The judgment of the court of appeals was entered on August 23, 2016. The petition for a writ of certiorari was filed on October 18, 2016. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. a. Congress has authorized the Securities and Exchange Commission (SEC) to bring civil enforcement actions seeking relief for violations of the Securities Exchange Act of 1934 (Exchange Act), the Investment Advisers Act of 1940 (Advisers Act), and the

Investment Company Act of 1940 (Investment Company Act). See 15 U.S.C. 78u(d)(1); 15 U.S.C. 80b-9(d); 15 U.S.C. 80a-41(d). Such actions may seek equitable relief as well as civil monetary penalties. See *ibid.*; Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931 (15 U.S.C. 78a note); see also 15 U.S.C. 77h-1(e), 78u-3(e), 80b-3(k)(5) (authorizing the Commission to order "accounting and disgorgement" in administrative proceedings).

"In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, * * * any Federal court may grant[] any equitable relief that may be appropriate or necessary for the benefit of investors." 15 U.S.C. 78u(d)(5). Federal courts' equitable powers in such cases include the authority to order "disgorge[ment]" of profits that were "acquired in violation" of those laws. *Porter* v. *Warner Holding Co.*, 328 U.S. 395, 398-399 (1946); see, *e.g.*, *United States SEC* v. *Maxxon, Inc.*, 465 F.3d 1174, 1179 (10th Cir. 2006), cert. denied, 550 U.S. 905 (2007).

b. Congress has not specified a statute of limitations for an SEC enforcement action alleging a violation of the Exchange Act, the Advisers Act, or the Investment Company Act. But Congress has enacted a statute of limitations, 28 U.S.C. 2462, that governs "penalty provisions throughout the U.S. Code." *Gabelli* v. *SEC*, 133 S. Ct. 1216, 1219 (2013). "This statute of limitations is not specific to * * * securities law; it governs many penalty provisions * * * . Its origins date back to at least 1839, and it took on its current form in 1948." *Ibid.* Section 2462 states:

> Except as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of

> any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued if, within the same period, the offender or the property is found within the United States in order that proper service may be made thereon.

28 U.S.C. 2462.

In *Gabelli*, this Court considered the applicability of Section 2462 in a case in which the SEC sought civil monetary penalties—that is, sanctions "which go beyond compensation, are intended to punish, and label defendants wrongdoers." 133 S. Ct. at 1223; see *id.* at 1224 (declining to "[a]pply[] a discovery rule to Government penalty actions"). The Court noted that "[t]he SEC also sought injunctive relief and disgorgement, claims the District Court found timely on the ground that they were not subject to [Section] 2462." *Id.* at 1220 n.1. The Court explained that "[t]hose issues are not before us." *Ibid.*

2. Petitioner owned and controlled two Commission-registered investment advisers: Technology Funding, Ltd., and Technology Funding, Inc. (collectively, the Advisers). See Pet. App. 3a-4a. The Advisers conducted the day-to-day operations of four business development companies: Technology Funding Medical Partners I, L.P.; Technology Funding Partners III, L.P.; Technology Funding Venture Partners IV, An Aggressive Growth Fund, L.P.; and Technology Funding Venture Partners V, An Aggressive Growth Fund, L.P. (collectively, the Funds). See *id.* at 2a-3a. The Funds "raised money from investors through public securities offerings and invested in private start-up companies that focused on technology, biotechnology, and medical diagnostics." *Ibid.*

Each Fund had a contract with the Advisers, signed by petitioner. Pet. App. 3a. The contracts prescribed how the Advisers would be compensated and "prohibited any payments to the Advisers that were not expressly specified." *Ibid.* Those restrictions on payment were consistent with the Advisers Act, which permits advisers of business development companies to be compensated "on the basis of a share of capital gains" only if the compensation does not exceed twenty percent of the clients' gains. 15 U.S.C. 80b-5(a)(1) and (b)(3); see Pet. App. 3a; see generally *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 189 (1963) (explaining that investment advisers, which owe clients a fiduciary duty of good faith and full disclosure, generally should not "share in [the] profits of [their] clients") (internal quotation marks omitted).

Beginning in 1995, and continuing through 2006, petitioner misappropriated $34.9 million from the Funds. See Pet. App. 3a, 5a. From 1995 through 2006, petitioner directed the Advisers' treasurer to take $23.8 million from the Funds to reimburse the Advisers for salaries and bonuses paid to officers of the Advisers (including petitioner). See *id.* at 3a. During the same period, he directed the treasurer to take $5 million from the Funds to make reimbursements for the Advisers' office rent. See *ibid.* And in 2000, he "caused the Advisers to take $6.1 million" from the Funds—an amount that petitioner told the SEC was for "tax distributions" but that largely went directly to petitioner (even though he paid "only $10,304 in federal taxes that year"). *Ibid.* Those payments "violated the contracts between the Advisers and the Funds" and exceeded the statutory limitations on compensation for investment advisers. *Id.* at 4a. Petitioner also took

various steps—including causing the Funds to make false filings with the SEC—to conceal the payments from the Funds' investors and others. *Ibid.*; see *id.* at 22a-24a.

3. a. In 2009, the SEC brought this civil enforcement action against petitioner in the United States District Court for the District of New Mexico, alleging violations of the Exchange Act, the Advisers Act, and the Investment Company Act. See Pet. App. 1a-2a; SEC C.A. Br. 7-8. After a trial, a jury found violations of all three statutes. The jury determined that petitioner had "knowingly and willfully converted the Funds' assets to his own use or to the use of another," and that he had "knowingly and substantially assisted the Advisers in defrauding the Funds, in filing false and misleading reports with the SEC, and in soliciting proxies using false and misleading proxy statements." Pet. App. 4a-5a; see SEC C.A. Br. 3 (jury found petitioner liable for primary violations and for aiding and abetting violations).

b. Based on the jury's liability determination, the SEC sought entry of final judgment ordering petitioner to "disgorge the amounts that [he] misappropriated in violation of [the] securities laws." Pet. App. 24a. The district court granted that request, ordering disgorgement of $34,927,329, plus prejudgment interest. See *id.* at 46a-47a; see also *id.* at 24a-32a, 36a-40a, 45a-47a (permanently enjoining petitioner from violating specific provisions of the securities laws, based on a "reasonable and substantial likelihood" of further violations, and imposing a monetary penalty of $2,354,593 for conduct within the five-year limitations period in Section 2462).

The district court rejected petitioner's argument that the disgorgement remedy constituted a "penalty" covered by the Section 2462 statute of limitations. The court explained that the equitable remedy of disgorgement covered only "ill-gotten gains earned by the defendant while in violation of securities laws," Pet. App. 41a (quoting *United States* v. *Telluride Co.*, 146 F.3d 1241, 1247 (10th Cir. 1998)), and that such compensation was "remedial" and "equitable" rather than punitive, *id.* at 42a; see *id.* at 43a-44a ("Requiring [petitioner] to give up his ill-gotten gains—even those he received many years ago and those he caused to be paid to third parties—is quintessentially equitable."); *id.* at 44a-45a.

c. On appeal, petitioner contended that Section 2462's five-year statute of limitations barred the district court's disgorgement order. The Tenth Circuit rejected that argument, holding that disgorgement is not a "penalty" or "forfeiture" under Section 2462. Pet. App. 10a-17a; see *id.* at 7a-9a (reaching the same conclusion with respect to the district court's injunction).

First, the court of appeals held that disgorgement is not a "penalty." Pet. App. 10a. The court explained that "the disgorgement remedy does not inflict punishment," but "leaves the wrongdoer in the position he would have occupied had there been no misconduct." *Id.* at 11a (citation and internal quotation marks omitted). While recognizing that "disgorgement serves a deterrent purpose," the court observed that "it does so only by depriving the wrongdoer of the benefits of wrongdoing." *Ibid.* The court further explained that "there is nothing punitive about requiring a wrongdoer to pay for all the funds he caused to be improperly

diverted to others as well as to himself." *Id.* at 12a (citation omitted).

Second, rejecting the holding of *SEC* v. *Graham*, 823 F.3d 1357 (11th Cir. 2016), the court of appeals concluded that disgorgement is not a "forfeiture." Pet. App. 13a; see *id.* at 13a-14a. The court stated that, "[w]hen the term *forfeiture* is linked in [Section] 2462 to the undoubtedly punitive actions for a *civil fine* or *penalty*, it seems apparent that Congress was contemplating the meaning of *forfeiture* in [a] historical sense." *Id.* at 15a. As used in its "historical sense," the court explained, the term "forfeiture" referred to an in rem procedure to seize property based solely on its involvement in an offense, without regard to whether "[t]he owner of the seized property" was "completely innocent of any wrongdoing" or whether "the value of the property taken" had any "relation to any loss to others or gain to the owner." *Id.* at 14a-15a. The court concluded that "[t]he nonpunitive remedy of disgorgement does not fit in that company"—particularly given that "we are to construe [Section] 2462 in the government's favor to avoid a limitations bar." *Id.* at 15a, 16a.

DISCUSSION

This case presents an issue that has divided the circuits: whether Section 2462 applies to claims for disgorgement. The court of appeals correctly held that disgorgement is not a "penalty" or a "forfeiture" to which that provision applies. 28 U.S.C. 2462. But because the issue is important to the administration of the securities laws, and the courts of appeals have reached conflicting conclusions, this Court's review is warranted.

1. The court of appeals correctly held that disgorgement is not a "penalty" or "forfeiture" within the meaning of Section 2462.

Disgorgement is relief "given in accordance with the principles governing equity jurisdiction." *Sheldon* v. *Metro-Goldwyn Pictures Corp.*, 309 U.S. 390, 399 (1940); see *SEC* v. *Cavanagh*, 445 F.3d 105, 118-120 (2d Cir. 2006) ("[C]hancery courts possessed the power to order equitable disgorgement in the eighteenth century."). Its purpose is "not to inflict punishment but to prevent an unjust enrichment." *Sheldon*, 309 U.S. at 399; see *Feltner* v. *Columbia Pictures Television, Inc.*, 523 U.S. 340, 352 (1998) ("[W]e have characterized as equitable * * * actions for disgorgement of improper profits."). Because of disgorgement's quintessentially remedial nature, disgorgement "differs greatly from * * * damages and penalties." *Porter* v. *Warner Holding Co.*, 328 U.S. 395, 402 (1946) (discussing equitable remedy of restitution); see *Gabelli* v. *SEC*, 133 S. Ct. 1216, 1223 (2013) (explaining that a "penalty" within the meaning of Section 2462 is a sanction "intended to punish" the defendant).

Disgorgement also is not a "forfeiture" within the meaning of Section 2462. In *Meeker* v. *Lehigh Valley R.R. Co.*, 236 U.S. 412 (1915), the Court stated that "[t]he words 'penalty or forfeiture' in" a predecessor version of Section 2462 "refer to something imposed in a punitive way for an infraction of a public law." *Id.* at 423. Disgorgement, by contrast, is intended to prevent unjust enrichment, not to punish a wrongdoer for having committed the violation. See *Sheldon*, 309 U.S. at 399. The court of appeals also observed that the word "forfeiture" has historically been used to refer to an "in rem procedure to take 'tangible property used

in criminal activity,'" without regard to the culpability of the property's owner. Pet. App. 14a (quoting *United States* v. *92 Buena Vista Ave.*, 507 U.S. 111, 118 (1993) (opinion of Stevens, J.)); see, *e.g.*, *United States* v. *Mann*, 26 F. Cas. 1153, 1154 (D.N.H. 1812) (Story, J.). The order at issue here, by contrast, imposed "an equitable obligation to return a sum equal to the amount wrongfully obtained, rather than a requirement to replevy a specific asset." *SEC* v. *Banner Fund Int'l*, 211 F.3d 602, 617 (D.C. Cir. 2000) (describing disgorgement remedy).

2. The decision below is consistent with decisions of other courts of appeals that have held that the Section 2462 statute of limitations does not apply to disgorgement. See *Riordan* v. *SEC*, 627 F.3d 1230, 1234-1235 & n.1 (D.C. Cir. 2010) (rejecting contention that disgorgement is a "forfeiture covered by § 2462," and stating that "there is no statute of limitations for SEC disgorgement actions"); *SEC* v. *Tambone*, 550 F.3d 106, 148 (1st Cir. 2008) (stating that Section 2462 applies "only to penalties sought by the SEC," not to disgorgement), reh'g en banc granted and opinion withdrawn, 573 F.3d 54 (1st Cir. 2009), reinstated in relevant part, 597 F.3d 436 (1st Cir. 2010); see also *SEC* v. *Rind*, 991 F.2d 1486, 1490-1493 (9th Cir.) (holding that the Commission's claims for disgorgement are not subject to any statute of limitations, without discussing Section 2462), cert. denied, 510 U.S. 963 (1993); cf. *SEC* v. *Pentagon Capital Mgmt.*, 725 F.3d 279, 288 (2d Cir. 2013) (affirming order to disgorge amounts wrongfully obtained more than five years before the Commission's complaint was filed, without addressing the applicability of Section 2462), cert. denied, 134 S. Ct. 2896 (2014).

The decision below conflicts, however, with the Eleventh Circuit's decision in *SEC* v. *Graham*, 823 F.3d 1357 (11th Cir. 2016), which held that "[Section] 2462's statute of limitations applies to disgorgement." *Id.* at 1363. In *Graham*, the court of appeals concluded that a "forfeiture" occurs "when a person is forced to turn over money or property because of a crime or wrongdoing," *ibid.*, and that disgorgement is "[t]he act of giving up something (such as profits illegally obtained) on demand or by legal compulsion." *Ibid.* (citation omitted; brackets in original). The court found "no meaningful difference in the definitions of disgorgement and forfeiture" and therefore deemed disgorgement to be a form of "forfeiture." *Ibid.*[1] *Graham* cannot be reconciled with the decision below, or with the decisions of the other courts of appeals (see p. 9, *supra*) that have construed Section 2462 not to apply to disgorgement.[2]

3. a. The question presented is important and warrants resolution by this Court.

"Disgorgement plays a central role in the enforcement of the securities laws." *Rind*, 991 F.2d at 1491. The Commission seeks disgorgement in the majority of its enforcement actions, so as to deprive wrongdoers of unjust enrichment obtained as a result of securities-

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[1] Because the court in *Graham* held that an SEC disgorgement remedy is a "forfeiture" within the meaning of Section 2462, the court found it unnecessary to decide whether disgorgement is also a "penalty" under that provision. See 823 F.3d at 1363 n.3.

[2] The question whether Section 2462 applies to disgorgement is currently presented in a fully briefed case pending in the Second Circuit. See *United States SEC* v. *Wyly*, No. 15-2821 (2d Cir.). It is also presented in a fully briefed and argued case pending in the Eighth Circuit. See *SEC* v. *Crawford*, No. 16-1405 (8th Cir.) (argued Nov. 16, 2016).

law violations. See, *e.g.*, U.S. SEC, *Select SEC and Market Data, Fiscal 2015*, www.sec.gov/reportspubs/select-sec-and-market-data/secstats2015.pdf (last visited Dec. 9, 2016); see also H.R. Rep. No. 616, 101st Cong., 2d Sess. 17 (1990).

In the Eleventh Circuit, where the SEC has two regional offices, see U.S. SEC, *SEC Regional Offices*, https://www.sec.gov/page/sec-regional-offices (last visited Dec. 9, 2016), the Commission is currently impeded by the decision in *Graham* from obtaining the full disgorgement remedies to which it is entitled. *Graham* affects SEC enforcement actions filed in nine federal judicial districts, as well as SEC administrative proceedings that are appealed to the Eleventh Circuit. The decision therefore stands as a significant obstacle to national uniformity in administration of the securities laws. See *Lampf, Pleva, Lipkind, Prupis & Petigrow* v. *Gilbertson*, 501 U.S. 350, 357-361 (1991) (opinion of Blackmun, J.) (indicating that the "federal interests in predictability and judicial economy counsel" national uniformity with respect to the statute of limitations for private claims for violation of Section 10(b) and SEC Rule 10b-5); see also, *e.g.*, *Wilson* v. *Garcia*, 471 U.S. 261, 266 (1985) ("Few areas of the law stand in greater need of firmly defined, easily applied rules than does the subject of periods of limitations.") (citation omitted).

b. This case is an appropriate vehicle for resolution of the question presented. Petitioner adequately preserved his argument that the disgorgement order in this case ran afoul of Section 2462. He contended in the court of appeals that "an order of disgorgement and a permanent injunction can qualify as punitive measures for purposes of [Section] 2462"; that "[g]iv-

en the impossibility of restoring the status quo *ante* * * * , the District Court's order of disgorgement * * * serve[s] only to penalize [petitioner]"; and that "the District Court's $53,004,432 disgorgement order is a form of punitive forfeiture imposed on [petitioner] for his proscribed conduct, going far beyond remedying the damage caused to the harmed parties by [his] action." Pet. C.A. Br. 45, 47-49 (citation and internal quotation marks omitted; final set of brackets in original).

If this Court grants certiorari and resolves the question presented in petitioner's favor, the disgorgement award in the district court's final judgment would be reduced. That judgment orders disgorgement of approximately $34.9 million. See Pet. App. 5a, 32a. A significant portion of the funds that petitioner misappropriated, however, were taken more than five years before the Commission filed its complaint in this case. See D. Ct. Doc. 181, at 1-2 (Jan. 21, 2015) (stating that "the limitations period for purposes of Section 2462 began on October 27, 2004, five years before the complaint, and ended on October 27, 2009," and that petitioner "took $5,004,773 within the limitations period"). Thus, while application of Section 2462 would not wholly preclude the imposition of a disgorgement remedy here, it would substantially reduce the amount that petitioner could be required to disgorge.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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